CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

July 21, 2003

H.R. 49
Internet Tax Nondiscrimination Act

As ordered reported by the House Committee on the Judiciary on July 16, 2003

SUMMARY

H.R. 49 would permanently extend a moratorium on certain state and local taxation of online services and electronic commerce, and would eliminate an exception to the prohibition for certain states. Under current law, the moratorium is set to expire on November 1, 2003. CBO estimates that enacting H.R. 49 would have no impact on the federal budget, but it would impose significant costs on some state and local governments.

By extending and expanding the moratorium on certain types of state and local taxes, H.R. 49 would impose an intergovernmental mandate as defined in the Unfunded Mandates Reform Act (UMRA). CBO estimates that the mandate would cause revenue losses to state and local governments that would exceed the threshold established in UMRA ($59 million in 2003, adjusted annually for inflation). While there is some uncertainty about the number of states affected, CBO estimates that the direct costs to states and local governments would probably total between $80 million and $120 million annually. CBO estimates that the bill contains no new private-sector mandates as defined in UMRA.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

CBO estimates that enacting H.R. 49 would have no impact on the federal budget.

INTERGOVERNMENTAL MANDATES CONTAINED IN THE BILL

The Internet Tax Freedom Act (ITFA) currently prohibits state and local governments from imposing taxes on Internet access until November 1, 2003. The ITFA, enacted as Public Law 105-277 on October 21, 1998, also contains an exception to this moratorium, sometimes referred to as the "grandfather clause," which allows certain state and local governments to tax Internet access if such tax was generally imposed and actually enforced prior to October 1, 1998.

H.R. 49 would make the moratorium permanent and would eliminate the grandfather clause. The bill also would state that the term "Internet access" or "Internet access services" as defined in ITFA would not include telecommunications services except to the extent that such services are used to provide Internet access, known as "aggregating" or "bundling" of services. These extensions and expansions of the moratorium constitute intergovernmental mandates as defined in UMRA.

ESTIMATED DIRECT COSTS OF MANDATES TO STATE AND LOCAL GOVERNMENTS

CBO estimates that repealing the grandfather clause would result in revenue losses for about 10 states and for several local governments totaling between $80 million and $120 million annually beginning in 2004. We also estimate that the change in the definition of Internet access could affect tax revenues for many states and local governments, but we cannot estimate the magnitude or the timing of any such additional impacts at this time.

UMRA includes in its definition of the direct costs of a mandate the amounts that state and local governments would be prohibited from raising in revenues to comply with the mandate. The direct costs of eliminating the grandfather clause would be the tax revenues that state and local governments are currently collecting but would be precluded from collecting under H.R. 49. States also could lose revenues that they currently collect on certain services if those services are redefined as access under the bill.

The Grandfather Clause

The primary and most immediate budget impact would be the revenue losses resulting from eliminating the grandfather clause that currently allows some state and local governments to collect taxes on Internet access. While there is some uncertainty about the number of jurisdictions currently collecting such taxes—and the precise amount of those collections—CBO believes that about 10 states (Hawaii, New Hampshire, New Mexico, North Dakota, Ohio, South Dakota, Tennessee, Texas, Washington, Wisconsin) and several local jurisdictions in Colorado, Ohio, South Dakota, Texas, Washington, and Wisconsin are currently collecting such taxes and that these taxes total between $80 million and $120 million annually. This estimate is based on information from the states involved, from industry contacts, and on data from the Department of Commerce. In arriving at this estimate, CBO took into account the fact that some companies are challenging the applicability of the tax to the service they provide and thus may not be collecting or remitting the taxes even though the states feel they are obligated to do so. Such potential liabilities are not included in the estimate.

It is possible that if the moratorium were allowed to expire as scheduled under current law, some state and local governments would enact new taxes or decide to apply existing taxes on Internet access during the next five years. It is also possible that some governments would repeal existing taxes or preclude their application to these services. Because such changes are difficult to predict, for the purposes of estimating the direct costs of the mandate, CBO considered only the revenues from taxes that are currently in place and actually being collected.

Definition of Internet Access

Depending on how the language altering the definition of what telecommunications services are taxable is interpreted, that language also could result in substantial revenue losses for states. It is possible that states could lose revenue if taxes that they are levying on services that are not defined as "access" would be considered access under this bill. Revenues could also be lost if Internet access providers choose to bundle products and call the product Internet access. Such changes would reduce state and local revenues from telecommunications taxes and possibly revenues from content currently subject to sales and use taxes. However, CBO cannot estimate the magnitude of these losses.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

This bill would impose no new private-sector mandates as defined in UMRA.

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